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NO. 87-1695
IN THE SUPREME COURT OF THE
UNITED STATES

OCTOBER TERM, 1988

H & H BEVERAGE
DISTRIBUTORS, INC.
Petitioner

v.

DEPARTMENT OF REVENUE OF THE
COMMONWEALTH OF PENNSYLVANIA
Respondent

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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QUESTIONS PRESENTED

1. Is a state taxing authority entitled to audit the tax records of a debtor in bankruptcy to ascertain the extent of any tax claims it may have?

2. When a state taxing authority's issuance of a "Notice of Audit Assessment" is the functional equivalent of an issuance of a "Notice of Tax Deficiency" as that term is used in the Bankruptcy Code, is the state's notice also excepted from the automatic stay provisions of the Code by U.S.C. 362(b)(9)?

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STATEMENT OF THE CASE

On January 20, 1984, H & H Beverage Distributors, Inc., a Pennsylvania corporation, filed a voluntary petition under Chapter 11 of the Bankruptcy Code, 11 U.S.C. 1101, et. seq., and was granted debtor-in-possession status. In August, 1984, the Commonwealth of Pennsylvania's Department of Revenue performed a tax audit on H & H Beverage's records due to the corporation's failure to file pre-petition sales tax returns and its failure to remit post-petition sales tax payments. Upon completion of the audit on August 27, 1984, the Department sent to the corporation a Notice of Audit Assessment. The notice set forth that for the audit period of January 1, 1981,

through July 30, 1984, the total balance claimed by the Department as sales taxes due was $162,981.16.

H & H Beverage pursued its administrative remedies as provided under Pennsylvania law with regard to the Notice of Audit Assessment and for a reassessment. Obtaining no result satisfactory to it, the corporation then appealed unsuccessfully to the Commonwealth's Board of Finance and Revenue. H & H currently has its appeal pending before the Pennsylvania Commonwealth Court.

On January 16, 1986, H & H filed a complaint with the bankruptcy court and argued, inter alia, that the Commonwealth's auditing its records after its bankruptcy petition had been filed and issuing the Notice were acts in violation of the automatic stay

provisions of the Bankruptcy Code. The Commonwealth responded that it was entitled to calculate its claim for the purpose of filing a proof of claim with the bankruptcy court and that its notice was excepted from the automatic stay provisions by 11 U.S.C. 362(b)(9).

The bankruptcy court agreed with H & H on both its claims and the Commonwealth timely appealed to the district court. The District Court held that, although the act of auditing alone did not violate the automatic stay provisions, the act of auditing and issuing the "Notice of Audit Assessment" constituted an act to collect the taxes in violation of the Bankruptcy Code. See H&H Beverage Distributors, Inc. v. Department of Revenue of Pennsylvania, 79 Bankr. 205 (E.D. Pa. 1987). Upon appeal, the Court of Appeals reversed,

holding that the act of auditing per se by a taxing authority for the purpose of ascertaining its tax claim does not violate the automatic stay and that the issuance of the notice was protected by 11 U.S.C. 362(b)(9). H & H's petition to the Court of Appeals for rehearing was denied. See H&H Beverage Distributors, Inc. v. Department of Revenue of Pennsylvania, 850 F.2d 165 (3d Cir. 1988).

ARGUMENT

1. THE DECISION OF THE COURT OF APPEALS DOES NOT CONFLICT WITH DECISIONS OF THIS COURT AND OTHER FEDERAL COURTS THAT A STATE TAXING AUTHORITY IS ENTITLED TO AUDIT THE TAX RECORDS OF A DEBTOR IN BANKRUPTCY TO ASCERTAIN THE EXTENT OF ANY TAX CLAIMS IT MAY HAVE.

The Court of Appeals has held that the conducting of a sales tax audit by the Commonwealth of Pennsylvania of the tax records of H & H Beverage, Inc., a debtor-in-possession in a Chapter 11 bankruptcy proceeding, did not violate the automatic stay provisions of Section 362 of the Code, 11 U.S.C. 362. The Court held that the Commonwealth was entitled to audit H & H to ascertain the extent of any claim it may have. H & H Beverage Distributors, Inc. v. Department of Revenue of Pennsylvania, 850 F.2d 165, (3d Cir. 1988). In its

petition for a writ of certiorari, H & H asserts that the holding on the right to audit conflicts with three principles enunciated by this Court:

1. that a state's power to assess and collect state taxes must submit to the federal laws controlling the administration of the bankruptcy estate;
2. that only the bankruptcy court has jurisdiction to hear claims against the bankrupt; and
3. that tax collecting agencies are fully subject to the Bankruptcy Code in their collection efforts.

We will address each of these assertions.

1. The Commonwealth does not dispute federal supremacy in the administration of the bankruptcy estate. In fact, the Commonwealth based

its act of auditing not only on its state revenue statutes but upon the United States Bankruptcy Code. H & H, as a debtor-in-possession, had all of the duties of a Chapter 11 trustee. Those duties included providing books and records for inspection as required by a government unit. See 11 U.S.C. 1106, 1107. See Nicholas v. U.S., 384 U.S. 678 (1966).

The Court of Appeals below stated that auditing a debtor's sales tax records does not by itself constitute an act to create a lien or collect a claim. Every creditor, including taxing authorities, has a right to determine if it has a claim against the debtor. See In re Remington Rand, 836 F.2d 827 (3d Cir. 1988). Prohibiting a tax audit would prohibit the taxing authority from filing a proof of claim in the

bankruptcy proceeding. The Court cited congressional comments and Bankruptcy Rule 3001 as evidence of congressional intent that taxing authorities are permitted to file claims against the bankruptcy estate. See 124 Cong. Rec. H 11110 (daily ed. Sept. 28, 1978) and H&H Beverage Distributors, 850 F.2d 165, 167 (3d Cir. 1988). The Court of Appeals concluded that to prevent governmental units from determining whether a tax deficiency existed would render meaningless Section 362(b)(9), which expressly permits taxing entities to issue notices of deficiencies.

H & H cites Gardner v. New Jersey, 329 U.S. 565, (1947), among other cases, for the principle of federal law supremacy in administration of the bankruptcy estate. Gardner involved litigation between the state of New

Jersey and a bankruptcy trustee over the validity and extent of a proof of claim filed by New Jersey with the bankruptcy court for taxes claimed due. New Jersey challenged the bankruptcy court's jurisdiction to adjudicate the issues raised. The Court upheld the bankruptcy court's power to adjudicate the issues arising from the proof of claim filed.

A fair reading of Gardner shows that it enhances the right of a public agency to participate as a creditor in a bankruptcy reorganization by filing a proof of claim. This includes filing a proof of claim and having that claim's allowance adjudicated by the bankruptcy court. See 11 U.S.C. 501 and 502. H & H fails to show any conflict between Gardner and the instant case.

H & H cites New York v. Irving Trust

Company, 288 U. S. 329, (1933) and Van Huffel v. Harkelrode, 284 U.S. 225, (1931) for the same supremacy principle. The Irwing Trust case sustained an order of the bankruptcy court that barred a state's tax claim because it was not filed with the court within the time fixed for such filing. The Van Huffel case upheld thepower of the bankruptcy court to order estate property sold free and clear of local tax liens. Neither of these cases shows a conflict with the decision of the Court of Appeals in the instant case.

2. Secondly, H & H asserts that only the bankruptcy court has jurisdiction to hear claims against the bankrupt. H & H's petition fails to show any conflict between this assertion and the decision of the Court of Appeals. H & H cites in its petition

Kalb v. Feuerstein, 308 U.S. 433, (1940) in support of the exclusive jurisdiction of the bankruptcy court to hear claims against the bankrupt. The Commonwealth has not challenged the jurisdiction of the bankruptcy court to hear claims against the bankruptcy estate. After ascertaining its tax claim by audit, the Commonwealth sent notice of the amounts established by audit to H & H and then duly filed its proof of claim with the bankruptcy court. It was H & H, as the debtor-in-possession, who chose to contest the audit and to seek administrative remedies in the state forums provided. Having failed in such an endeavor, H & H then filed its complaint before the bankruptcy court.

3. Lastly, H & H compares the instant case to In re Nashville White

Truckers, Inc., 731 F.2d. 376 (6th Cir. 1984) and implies a conflict between the Courts of Appeal. Nashville White shows that the Commissioner of Revenue for the state of Tennessee was asserting, inter alia, a right to levy on property of the bankrupt estate to satisfy a state tax debt incurred by the debtor-in-possession and to exercise this right without first pursuing relief from the automatic stay through the bankruptcy court. The Court of Appeals affirmed the District Court in holding that such direct action was not permitted by law. The ascertainment of the amount due on a claim is not the same act as an act to levy or confiscate property to resolve a debt. The Nashville case does not conflict with the instant case.

The Commonwealth submits that H & H

has failed to produce any decisions of this Court or of any other federal court that conflicts with the decision of the Court of Appeals below that a state taxing authority is entitled to audit the tax records of a debtor in bankruptcy to ascertain the extent of any tax claim it may have. The petition for a writ of certiorari should be denied.

2. THE DECISION OF THE COURT OF APPEALS DOES NOT CONFLICT WITH DECISIONS OF THIS COURT AND OTHER FEDERAL COURTS THAT WHEN A STATE TAXING AUTHORITY'S ISSUANCE OF A "NOTICE OF AUDIT ASSESSMENT" IS THE FUNCTIONAL EQUIVALENT OF AN ISSUANCE OF A "NOTICE OF TAX DEFICIENCY" - AS THAT TERM IS USED IN THE BANKRUPTCY CODE, THE NOTICE IS, THEREFORE, AN ACT EXCEPTED FROM THE AUTOMATIC STAY PROVISIONS OF THE CODE BY 11 U.S.C. 362(b((9).

Section 362(a) (4) (5) (6), of the United States Bankruptcy Code 11 U.S.C. 362(a) (4), (5), (6), prohibits:

> ...(4) any act to create, perfect, or enforce any lien against property of the estate;
>
> (5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;
>
> (6) any act to collect, or to recover a claim against the debtor that arose before the commencement of the case under this title. (Emphasis added.)

Section 362(b)(9) reads in pertinent

part:

> The filing of a petition...., does not operate as a stay--...)
> (9) under subsection (a) of this section, the issuance to the debtor by a governmental unit of a notice of tax deficiency;.... (Emphasis added.)

Section 101(26) defines the term "governmental unit" to include a state or an instrumentality of a state. Therefore, Section 362(b)(9) is an exception to the automatic stay provision of Section 362(a) that applies to a state taxing authority. The Court below analyzed the statutory language and the legislative history and concluded that the Bankruptcy Code provides that all governmental taxing entities should receive equal treatment under Section 362. 850 F.2d at 168. Noting that the origin of Section 362(b)(9) was in the federal tax system,

the court examined and compared the federal Internal Revenue Service "Notice of Tax Deficiency" to the Pennsylvania "Notice of Audit Assessment." The Court concluded that the Commonwealth's notice was the functional equivalent of the notice of tax deficiency that is permitted under Section 362(b)(9). The Court found that there was no reason to permit the federal notice pursuant to 362(b)(9) and yet bar the equivalent state notice.

H & H bases its petition upon its assertion that the decision of the Court of Appeals will seriously hinder efficient administration of cases under the Bankrupty Code and that the methodology of statutory construction used by the court below conflicts with decisions of this Court. The Commonwealth submits that neither the

act of auditing nor the act of issuing its notice of audit assessment hinders the efficient administration of the Bankruptcy Code.

In essence, H & H argues that a taxing authority should have to petition the bankruptcy court for relief from the automatic stay prior to doing a tax audit. There is no provision in the Code that requires a creditor to seek such relief prior to calculating its claim in preparation for filing a proof of claim. If such a procedure were established, the bankruptcy court would be deluged with such petitions not only from taxing authorities, but from all other creditors.

H & H cites In re Stringer, 847 F.2d 549 (9th Cir. 1988), as an example of the proper statutory construction the Court in this instant case should have

used. In Stringer, the Court of Appeals held that the modification by a state court of a child support order after the filing of the bankruptcy petition was violative of the automatic stay provision and was not excepted by Section 362(b)(2). The Court held that the exception applied only to proceedings to collect child support that had been awarded by a court order entered prior to the filing of the bankruptcy petition. In so doing, the court noted that exceptions to the stay should be read narrowly to secure the broad grant of relief to the debtor. Stringer, supra. at 552.

Stringer does not conflict with the decision in the present case. The Stringer court and the court in the instant case both sought congressional intent by examining the involved

statutes, legislative history and prior case law. In Stringer, the court discerned that it was not the intent of Congress to include in the exemption of collection of child support the further concepts of modification, new suits, or similar actions. In the present case, the Court is not expanding the involved exception. It is clear that 362(b((9) applies to all governmental units, state and federal. It is also clear that "Notice of Tax Deficiency" as a term is of federal origin and that not all government units use such a term in their tax notices. Having found the notices of the state and of the IRS to be functional equivalents, it was not an expansion of the exception for the court to hold that such a state notice is also protected by Section 362(b)(9).

The Court of Appeals reached the

correct result and there is no reason to disturb the decision

CONCLUSION

For the above reasons, the petition for writ of certiorari should be denied.

Respectfully submitted,

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